SENATE TAXATION
EXHIBIT NO. 1
DATE 1.20.11
BILL NO. SB 94

SB ~~36~~ 94 for 2011

The following states require worldwide combined reporting:
Alaska
California
Idaho
Montana
North Dakota
Utah

When computing taxable income, worldwide combined reporting requires the inclusion of the entire unitary groups income – income from subsidiaries incorporated in the United States as well as income from foreign parents or subsidiaries incorporated outside the United States. The federal government generally taxes only income derived from sources within the United States and does not tax income from foreign subsidiaries.

All of the above states do provide for a water's edge election. The water's edge election for states was a product of controversy over the application of the worldwide unitary business concept to multinational corporations. Fearing the federal government might pass legislation that would eliminate worldwide combined reporting, the states adopted legislation allowing for a water's edge election. This election provided for the exclusion from the unitary combined group, income of those corporations that are incorporated in a foreign country and/or conduct most of their business abroad. At the time state legislation was being passed, multinationals were lobbying not only for the exclusion from the unitary combined group of corporations incorporated in a foreign country, but also for the exclusion of domestically incorporated subsidiaries that had more than 80% of their property and payroll outside the United States (so called 80/20 corporations).

Recent audits conducted by the Department of Revenue of some water's edge corporations do show that corporations are manipulating income by having members of the water's edge group pay interest or royalties to excluded 80/20 corporations. If no exclusion of 80/20 corporations is allowed, then these types of transactions will be a wash – expense for one subsidiary and income for the other subsidiary.

Which worldwide states allow or don't allow for an exclusion of 80/20 corporations?

1. Alaska

Alaska **allows** for the exclusion of 80/20 companies. However, Alaska does **not** permit oil & gas companies to file a water's edge return – these corporations must file worldwide. Oil and gas companies account for approximately 90% of Alaska's corporate tax revenues. As such, the 80/20 company exclusion is somewhat of a non-issue for Alaska.

2. California
California has **never allowed** for an exclusion of 80/20 corporations. Ben Miller of the California Franchise Tax Board explained that the purpose of the water's edge election was to bring the state's apportionable tax base more in line with what the federal government taxes. Domestically incorporated corporations are taxed at the federal level and should be taxed at the state level also.

3. Idaho
Idaho **does not allow** for the exclusion of 80/20 corporations. Idaho did initially allow for the exclusion of 80/20 corporations – but has not since at least 1993.

4. North Dakota
North Dakota **allows** for the exclusion of 80/20 corporations. However, North Dakota also has a provision that allows for the reversal of any transactions between members of the water's edge group and excluded 80/20 corporations – thereby eliminating the manipulation of income and expenses.

5. Utah
Utah **allows** for the exclusion of 50% of 80/20 company income from the water's edge group. However, Utah also has provisions for the reversal of any intercompany income and expenses between a corporation within the water's edge group and an 80/20 company.

6. Montana
Current Montana code does allow for the exclusion of 80/20 corporations. In addition, Montana code does not have provisions for the reversal of any intercompany income or expense between a corporation within the water's edge group and an 80/20 company. This makes Montana unique from the other worldwide states and provides for an opportunity for corporations to manipulate income and expenses between members in the water's edge group and 80/20 corporations.

Other Combination States
Many other states require or have the ability to require combined unitary filings at the domestic level (they do not include income from corporations incorporated outside the United States). Some of these states are Arizona, Colorado, Hawaii, Illinois, Indiana, Kansas, Louisiana, Maine, Minnesota, Nebraska, Oregon, New Hampshire, New York, North Carolina, and Tennessee. The majority of these domestic combined states **do not allow** for the exclusion of 80/20 corporations.

It was suggested that the proposed legislation to eliminate the 80/20 corporation exclusion would make Montana unique from other states. It actually appears that this proposed legislation would bring Montana more in line with other combination states.